Mortgage Insurance Companies of America

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December 24, 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1366

Dear Ms. Johnson:

The Mortgage Insurance Companies of America (MICA) is pleased to comment on the Federal Reserve Board (FRB or Board) proposal to revise the Truth-in-Lending Act (TILA) disclosures related to closed-end mortgage loans.[1] MICA supports the notice of proposed rulemaking (NPR) because we believe strongly in the critical importance not only of enhanced mortgage disclosures, but also of restrictions on potentially risky or abusive mortgage loans. We have consistently urged the Board to act in an array of prior comment letters to the FRB. MICA is grateful for the work done by the Federal Reserve to date in this area, and support not only quick action on this NPR, but also additional consumer protections vital to ensuring long-term, sustainable home ownership.

MICA represents the U.S. private mortgage insurance (MI) industry, which currently has $886 billion of primary insurance in force[2] to protect lenders and investors in mortgages with high loan-to-value (LTV) ratios. MI also protects borrowers because mortgage insurance puts private capital at risk, regardless of whether loans are securitized, ensuring long-term alignment of loan-structure incentives with those of the initial borrower and ultimate investor. We believe MI is "skin in the game" that meets the desire of the G-20 related to securitization reform.[3] Members of MICA are unique among large holders of mortgage risk, let alone that related to high-LTV loans. MI firms are not only absorbing losses in the current mortgage crisis, but also have adequate capacity to underwrite new business and contribute to the recovery. This is because mortgage insurers (MIs) have a counter-cyclical capital requirement (the contingency reserve) that

[1] Truth in Lending, 74 Fed. Reg. 43,232 (Aug. 26, 2009).
[2] MICA, *Monthly Statistical Report for October*, *available at* http://www.privatemi.com/news/statistics/pdfs/october_2009_press_table.pdf.
[3] G-20 Leaders' Statement: The Pittsburgh Summit (Sept. 25, 2009), *available at* http://www.pittsburghsummit.gov/mediacenter/129639.htm.

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ensures capital is amassed during economic boom times to protect MI solvency and new-business capacity even under the acute stress now evident throughout the U.S. mortgage market. This unique structure has brought new private capital into the MI industry at a time when other large holders of mortgage risk are under acute strain.

In this letter, MICA is pleased to comment on aspects of the NPR that affect private mortgage insurance. As detailed below, our specific comments on this NPR include:

- MICA strongly supports the intent of the proposal and rapid action to finalize and implement it. Reform should not be delayed on grounds that change will disrupt the mortgage-market's recovery. On the contrary, urgently-needed reform will promote and hasten the recovery even as it prevents another crisis.

- MICA supports the proposed revisions to the manner in which the finance charge is calculated for purposes of determining the annual percentage rate (APR). Mortgage insurance is already included in this charge, leading some borrowers to believe that it is an added cost and instead to pursue other mortgage options (i.e., piggyback loans) where the added costs are not clearly reflected in the initial disclosure. These alternatives to MI are often more costly to borrowers and have proven to be far more risky, as evidenced by the problems second liens pose to mortgage-loan modification. Further, omission of any costs to borrowers from the APR may lead lenders not only to piggyback or similar structures to circumvent MI, but also to other loan structures to evade the Federal Reserve's new APR-triggered consumer protections. Such evasions would undermine consumer protection and mortgage-market stability.

- The additional disclosures proposed by the FRB will enhance consumer understanding of complex mortgage terms and should be adopted. In addition to protecting consumers from risk that can threaten homeownership, enhanced disclosures that promote prudent lending may limit foreclosures.

- The proposed revisions to disclosures specifically related to mortgage insurance are clarifications of current practice and should be adopted.

I. The FRB Should Finalize New Protections for Mortgage Borrowers

MICA has long advocated additional protections for U.S. mortgage markets, beginning with letters in 2002 that alerted the Federal Reserve and other regulators to the looming crisis. Because of the role MI plays as capital at risk throughout the mortgage origination and securitization process, mortgage insurer incentives are, as noted, aligned with borrowers and thus strongly support stringent safeguards that ensure sustainable, prudent, long-term home ownership. We view the current NPR as an important step in overdue reform of mortgage regulation and we thus urge quick action on it.

To be sure, MICA understands that implementation of the FRB's proposal will require significant changes by mortgage originators that may present operational complications and, perhaps, new costs. To minimize these, the Federal Reserve Board should work closely with other regulators, most notably the Department of Housing and Urban Development (HUD), to make regulatory changes as similar as possible and ensure a parallel implementation timetable. Similarly, the FRB should, to the greatest degree possible, anticipate statutory change to minimize regulatory revisions that may lead to undue disruption.

However, even as the FRB works with HUD, other regulators and Congress, MICA urges it to finalize its new regulatory regime. The fate of all of these other actions is uncertain even as borrowers continue to seek new home-purchase and refinancing mortgages. The more loans advanced without clear, up-front consumer understanding of terms and conditions – especially with regard to risky mortgage structures like payment-option and negative-amortization loans – the greater the chance for quick resumption of imprudent lending practices. These will lay the seeds for yet another mortgage crisis with tragic consequences for borrowers and costly implications for the U.S. and global economy. The Board in fact began its review of mortgage finance in 2004, when an advance notice of proposed rulemaking (ANPR) was issued.[4] We are sure the FRB shares our belief that, had more rapid action been taken on the concerns that sparked the ANPR then, the ongoing crisis now might have been averted or, at the least, lessened.

[4] Truth in Lending (Regulation Z), 69 Fed. Reg. 70,925 (Dec. 8, 2004).

II. The Finance Charge Should be Expanded to Cover Additional Costs

In the NPR, the FRB would replace the current approach to calculating the finance charges used to calculate the annual percentage rate (APR) with an "all-in" approach that includes all of the costs the consumer must pay to get a mortgage (other than certain transfer taxes and other charges outside the lender's control). In 1998, the FRB and HUD filed a report with Congress recommending this approach.[5] Had it been adopted then, much in the subsequent high-risk nature of the U.S. mortgage market might have been averted because consumers would have had a more accurate understanding of the true cost of a mortgage. To be sure, the finance-charge disclosures are not sufficient to address recent abuses, and MICA thus applauds other proposed improvements to mortgage disclosure, discussed in detail below.

In considering this proposal, the FRB notes that the all-in APR may bring more loans under various thresholds that determine additional consumer protection. FRB studies in conjunction with the NPR make clear that the proposed approach to calculating the finance charge would bring more loans under the Home Ownership and Equity Protection Act (HOEPA) restrictions,[6] increasing the share of first-lien refinance and home improvement loans covered by HOEPA by 0.6 percent. Although the percentage increase is minimal, the small number of originated HOEPA loans means that the proposal would lead to a 350 percent increase in HOEPA-subject mortgages. However, the sharp increase in HOEPA loans should not obscure the very small number of affected mortgages. Loans that tread the threshold of higher cost through required finance charges should be subject to all consumer protections to ensure that borrowers do not unknowingly take on high cash charges at the outset of a mortgage or fees paid over the course of the loan that threaten long-term home ownership. Public policy should promote cash accumulation upon home purchase and the lowest-possible cost throughout the life of a mortgage consistent with sustainable long-term home ownership.

In addition to the HOEPA calculation, the FRB in the NPR estimates that approximately three percent of typical first-liens would become higher-priced mortgages subject to additional protection.[7] Although this affects many more loans than the HOEPA calculation, MICA does not believe the finding argues against the proposed

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[5] Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act (July 1998), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/tila.pdf.

[6] 12 C.F.R. § 226.32 (2009).

[7] 12 C.F.R. § 226.35 (2009).

approach to the finance charge. Again, any higher-cost loan – which the all-in calculation of the finance charge appropriately reflects – should be treated as a higher-priced loan subject to consumer protections. Any other approach would encourage evasive structuring of up-front fees and long-term charges that undermine the FRB's appropriate consumer-protection and market-stability objectives. If Congress expands the concept of higher-priced loans to other borrower protections, an all-in finance charge will ensure ongoing consistent treatment of loans and, should the test at some point prove too severe for some contemplated protections, this can be considered in advance of any new sanctions, not used as a rationale to limit borrower protection as proposed in the NPR.

As noted, mortgage insurance is included in the current finance charge.[8] Because of the current, complex and arbitrary nature of the APR calculation, MI is one of the few discretionary charges factored in to the APR. As a result, it is often singled out by lenders as a "cost" to the borrower, leading consumers sometimes to select other loan structures that appear more favorable under the APR calculation but that in fact pose higher costs over the life of the mortgage and greater risk should the borrower encounter difficulties. Further, in light of the recent FRB actions to use the APR to trigger loans subject to HOEPA or the higher-price protections, lenders may omit MI from loans to skirt these requirements. This is regulatory arbitrage that exposes borrowers to real risk and undermines the FRB's goals. A consistent approach to the finance-charge calculation would eliminate this potential distortion and thus enhance both borrower protection and market stability.

Because the HOEPA triggers and higher-priced loan threshold were only established in 2008, there is little history or market experience with them, let alone any under normal, stable conditions. As a result, there is as yet little data on the degree to which lenders may use the current, artificial calculation for the finance charge to skirt these requirements. However, there is clear evidence in the run-up to the crisis that exclusion of all charges from the finance charge combined with including MI in the APR led to a serious problem: the sharp growth in mortgages with simultaneous second liens, loans also known as "piggyback" mortgages. In these loans, a borrower takes out a first and a second lien at the same time to skirt the requirements in the Fannie Mae[9] and Freddie Mac[10] charters that any loans with LTVs above eighty percent bear MI or another form of robust credit enhancement. These loans were sold to borrowers as less costly than single liens with MI, but this was often not the case once the true cost

[8] 12 C.F.R. § 226.4(b)(5) (2009).
[9] 12 U.S.C. § 1717(b)(2) (2009).
[10] 12 U.S.C. § 1456(a)(2) (2009).

of both loans was calculated and compared to a first lien with MI, especially when taking into account the fact that MI may be cancelled after loans amortize or otherwise reach certain LTVs.

Under market stress, piggyback mortgages have been shown not only to pose undue cost to borrowers, but now also serious risk. MICA has long alerted regulators to the risk of borrowers taking out complex, structured loans with little, if any, equity to protect them against housing-market stress or unanticipated personal crises. As the mortgage-market weakened, Chairman Bernanke rightly pointed to this issue in remarks on March 4, 2008.[11] However, little since has been done to prevent ongoing reliance on piggyback mortgages to evade appropriate borrower protections. Indeed, as the crisis has worsened, piggyback mortgages have been a contributing factor, making it far more difficult for servicers to modify first liens and prevent foreclosure. The Obama Administration has attempted to deal with second liens in recent revisions to the Making Home Affordable program,[12] but little progress has been made to date. This reflects the complexity of the second-lien problem and highlights the urgent importance of ensuring that mortgage-market practice going forward does not contain incentives for loan structuring to artificially reduce the finance charge calculated into the APR.

III. Proposed Disclosures Support Market Stability and Consumer Protection

MICA has above provided specific comments on the proposed finance-charge calculation. In addition, the NPR includes proposed new disclosures related to the finance charge, including renaming it with the term "interest and settlement charges" and improving the prominence of the APR disclosure. MICA supports all of these proposals.

The NPR also would require additional disclosures at application, at least three business days after an application, at least three business days before consummation, and after loan consummation. All of these disclosures would be required for loans secured by real property or a dwelling, thus extending to all mortgage loans, not just those for primary residences.

[11] Chairman Ben S. Bernanke, Speech at the Independent Community Bankers of America Annual Convention (Mar. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20080304a.htm.
[12] Press Release, U.S. Treasury Department, *Obama Administration Announces New Details on Making Home Affordable Program* (Apr. 28, 2009), *available at* http://www.financialstability.gov/latest/pr04_28.html.

In general, all of the proposed new disclosures enhance the information available to consumers and the clarity of important information in areas such as loan terms, interest rates, additional costs and related services. MICA thus supports the NPR in this regard.

IV. Specific Disclosures Regarding MI Raise No Concerns

Proposed comment 38(c)(3)(i)(C)-1 would clarify the types of taxes and insurance that would need to be included in the estimate. Proposed comment 38(c)(i)(C)-2 would provide guidance on how to determine the length of time for which mortgage insurance payments must be included in the estimate. Under the proposed comment, substantially similar to current comment 18(g)-5 (to section 226.18), the payment amount should reflect the consumer's mortgage insurance payments until the date on which the creditor must automatically terminate coverage under applicable law, even though the consumer may have a right to request that the insurance be canceled earlier.

Another provision of the Proposed Rule would require, if applicable, a statement substantially similar to the following: "Private Mortgage Insurance (MI) is required for this loan. It is included in your escrow." If other mortgage insurance is required, such as insurance or guaranty obtained from a government agency, the creditor would be required to omit the word "private" from the description.

MICA does not believe either of these proposals raises problems for borrowers, lenders or private mortgage insurers and thus recommends adoption as proposed.

Conclusion

MICA is grateful for the work by the Federal Reserve Board to improve U.S. mortgage-lending practice through enhanced disclosure requirements and product terms and conditions. We support the NPR's proposed changes for closed-end mortgage loans and urge quick final action on them. We would be pleased to provide any additional information or analytical support of assistance to the Board in this endeavor.

Sincerely,

Suzanne Hutchinson

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